European Unemployment Revisited: Shocks, Institutions, Integration

Giuseppe Bertola
Università di Torino

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Unemployment.

Austria, Belgium, Finland, France, Germany, Ireland, Italy, Netherlands, Portugal, Spain.

Denmark, Norway, Sweden, Switzerland, United Kingdom.

Australia, Canada, Japan, New Zealand, United States.

5-year periods, since 1960. Empirics, with theory.
Blanchard and Wolfers (BW).
As of late 1990s,
Unemployment rise stronger in Europe than in comparison group of advanced countries.

Why different consequences of broadly similar events for broadly similar countries?
«Labor market institutions». 
New data.

Unemployment declines, diverges in Europe and elsewhere.

New decades of Labor market reforms, Globalization, EMU, Great recessions.

Do institutions matter differently at different times, in theoretically sensible ways?

Using 1990s indicators,

(1) BW: yes. Most time-interactions significant and correctly signed.

(2) Current complete sample: yes... weaker.

(3) Recent data: even weaker.

Institutions have changed. But similar message from time-varying indicators.
Histories of country-specific SHOCKS.

Total factor productivity: used to slow down.

Real interest rate: up in the 1980s, down to stagnation.

«labor demand» (share, ULC) indicator of wage misalignment.
Do shocks matter in theoretically sensible ways?

(1) BW: yes. Significant and correctly signed.
(2) Current complete sample: yes...
(3) Recent data: No.

Worse fit. Wrong sign for TFP growth.

Something else began to matter since BW.
Think...

\[ \tilde{\mu} \approx \frac{\gamma}{1 - x} + \frac{1 - \gamma}{\gamma} \left( \log(a_0) - \log(a_1) \right) \]

Labor demand elasticity

relative non-labor income of decisive voter

distribution-motivated :: institutions ::

(wage preset, misaligned) :: shock ::

\[ y(l) = (k_d)^\gamma (al)^{(1-\gamma)} \]

Theory...Empirics. What constant? What varies?

Financial integration and institutions: Reforms

Financial integration and labor markets: New shock type
Financial integration: new, matters NOW.

(mid-90s institutions... constant??)
Institutions have changed,

Table 9: Capital flows and labor policy reforms

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<td>Current account / GDP</td>
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p-value * .1 ** .05 *** .01 (robust t stats).
Columns 3, 4: current account instrumented with gross capital flows and EMU dummy.

Current account surplus ↔ Labor market deregulation.
Maybe only some countries heed policy research, export more...

...maybe both triggered by financial integration:
• Common "race-to-bottom" elasticity effects, but also
• Policy incentives of decisive individual x depend on whether capital flows in or out.
  Spain ... Germany, in EMU
(Blanchard & Giavazzi)
Institutions vary and directly influence unemployment:

- **R² no institutions**, -0.05  
  -0.03

- **R² no shocks**, -0.12  
  -0.04

**EPL**: dynamic shock interactions, data and simple theory do not disagree.

**EPL**

Wage-relevant institutions, insignificant on level

Institutions and shocks both (some) matter.
Olivier Blanchard

"had entered the 1970s without a model of the natural rate, and had not anticipated stagflation"

To explain persistent unemployment,

"adverse shocks interacting with country-specific collective bargaining structures."

Still works in many respects. Not all.

Theory, integration matters:

(1) as a shock, (2) for policies when unemployment is a side effect of distribution tensions.


Stabilize capital flows, but (like integration) unpopular.